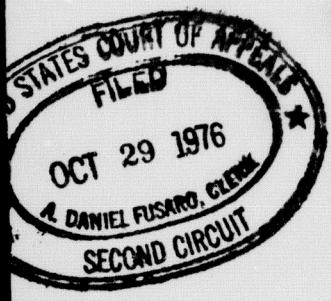
United States Court of Appeals

for the Second Circuit

APPELLANT'S REPLY BRIEF

Affidavit

76-6097
76-6098
76-6099



To be argued by
PETER C. SALERNO

United States Court of Appeals

FOR THE SECOND CIRCUIT

Docket No. 76-6098

F. W. EVERSLEY & CO., INC., & F. W. EVERSLEY & CO., INC., on behalf of itself and all other persons entitled to share in funds allocated for the improvement of real property owned by THE EAST NEW YORK NON-PROFIT H.D.F.C., INC.,

Plaintiff-Appellee,

—v.—

CARLA A. HILLS, Secretary of the United States Department of Housing and Urban Development, THE EAST NEW YORK NON-PROFIT H.D.F.C., INC., and THE EAST NEW YORK SAVINGS BANK,

Defendants,

CARLA A. HILLS, Secretary of the United States Department of Housing and Urban Development.

Defendant-Appellant.

REPLY BRIEF FOR DEFENDANT-APPELLANT HILLS

Docket Nos. 76-6097, 76-6099

F. W. EVERSLEY & CO., INC. & F. W. EVERSLEY & CO., INC., on behalf of itself and all other persons entitled to share in funds allocated for the improvement of real property owned by Brownsville Housing Development Fund Corporation,

Plaintiff-Appellee,

—v.—

BROWNSVILLE HOUSING DEVELOPMENT FUND CORPORATION, CARLA A. HILLS, Secretary of the United States Department of Housing & Urban Development & MANUFACTURERS HANOVER TRUST CO.,

Defendants,

CARLA A. HILLS, Secretary of the United States Department of Housing and Urban Development and MANUFACTURERS HANOVER TRUST CO.,

Defendants-Appellants.

ON APPEAL FROM THE UNITED STATES DISTRICT COURT FOR THE SOUTHERN DISRICT OF NEW YORK

ROBERT B. FISKE, JR.,
United States Attorney for the Southern District of New York,
Attorney for Defendant-Appellant Hills.

PETER C. SALERNO,
PATRICK H. BARTH,
Assistant United States Attorneys,
Of Counsel.

TABLE OF CONTENTS

TABLE OF AUTHORITIES

Cases:

United States Court of Appeals

FOR THE SECOND CIRCUIT

Docket No. 76-6098

F.W. EVERSLEY & CO., INC., & F. W. EVERSLEY & CO., INC., on behalf of itself and all other persons entitled to share in funds allocated for the improvement of real property owned by The East New York Non-Profit H.D.F.C., INC.,

Plaintiff-Appellee,

—v.—

CARLA A. HILLS, Secretary of the United States Department of Housing and Urban Development, THE EAST NEW YORK NON-PROFIT H.D.F.C., INC., and THE EAST NEW YORK SAVINGS BANK,

Defendants,

CARLA A. HILLS, Secretary of the United States Department of Housing and Urban Development,

Defendant-Appellant.

Docket Nos. 76-6097, 76-6099

F. W. EVERSLEY & CO., INC., & F. W. EVERSLEY & CO., INC., on behalf of itself and all other persons entitled to share in funds allocated for the improvement of real property owned by Brownsville Housing Development Fund Corporation,

Plaintiff-Appellee,

—v.—

BROWNSVILLE HOUSING DEVELOPMENT FUND CORPORATION, CARLA A. HILLS, Secretary of the United States Department of Housing and Urban Development and MANUFACTURERS HANOVER TRUST CO.,

Defendants,

CARLA A. HILLS, Secretary of the United States Department of Housing and Urban Development and MANUFACTURERS HANOVER TRUST CO.,

Defendants-Appellants.

REPLY BRIEF FOR DEFENDANT-APPELLANT HILLS

Preliminary Statement

Appellant Carla A. Hills, the Secretary of Housing and Urban Development ("the Secretary" and "HUD" respectively) submits this brief in reply to appellee's brief, and to the *amicus curiae* brief submitted by the Subcon-

tractors Trade Association, Inc. in support of appellee's position.*

The *Amicus* Brief

The *amicus* urges affirmance on the same legal grounds as urged by Eversley. It claims that certain of its members were subcontractors on the projects involved in these cases, that they have not been fully paid, that they "had been led to believe that they could look to payment for the work done by them to HUD," (*amicus* brief at 3), and that "[i]f such monies are not eventually recovered by them, then the financial disaster which has overtaken the construction industry generally in the metropolitan area will have been seriously aggravated." *Amicus* brief at 2.

There is no support in the record for the reliance on HUD that the *amicus* claims. Furthermore, since the principal monies at issue here constitute 5% of the construction cost, each subcontractor should be owed by Eversley no more than 5% of its total bill, assuming that Eversley had been properly paying its subcontractors as the work progressed.

Most importantly, subcontractors and suppliers are, or were, more than adequately protected by substantial payment bonds (A. 203-07; B. 184-88). In *East New York* the amount of that bond is $1,414,544 (A. 203), and

---

* On October 18, 1976, the Honorable Murray I. Gurfein of this Court granted leave to file the *amicus* brief, "provided there is furnished within five (5) days of this order a listing of the names of each of this [*sic*] 'Subcontractors' and 'Suppliers' whom the Trade Association seeks to represent in this appeal." As this brief goes to press, the Government does not know if this condition has been complied with.

in *Brownsville* the amount of the bond is $7,709,532 (B. 184)). These amounts are substantially more than the amount Eversley recovered in each of these cases in the District Court.

These bonds provide that subcontractors and materialmen may sue the surety directly for all sums due them, up to the amount of the bond, if they have not been paid in full within 90 days of the time they last furnished work or materials to the project (A. 203; B. 184). It is true that the claimant must give the surety written notice of his claim within 90 days of the date he last furnished work or labor (*id.*), and apparently many of the subcontractors and suppliers have failed to comply with this provision. There is no explanation in the record for this failure. The Government submits that well-advised subcontractors and materialmen would rely on these substantial bonds to protect them if their general contractor failed to pay them, rather than HUD, which had no obligation to pay them.

The Facts Stated in Eversley's Brief

Eversley would have this Court believe that it is the only party that suffers from the unfortunate outcome of the projects involved in these appeals, if the Government's position is sustained (Eversley's brief at 7-8). In fact the Government bears the major portion of the loss under its insurance agreement, even if it prevails here. The Government has paid or will pay millions of dollars to the banks * pursuant to its insurance agreement, and the

---

* Government counsel is informed that, contrary to the assertions in Eversley's brief, the assignment of the mortgage in the *Brownsville* case was recorded on September 8, 1976. The assignment in *East New York* had been completed before the District Court's decision. Thus the Government now holds the mortgage in both cases.

only way it can recoup any portion of that sum is to foreclose the mortgages. The Government can receive a windfall in these cases only in the unlikely event that the buildings yield more in a foreclosure sale than the Government paid the banks.

Eversley also asserts that normally the mortgage would be increased at final closing to cover change orders (Eversley's brief at 9-10).* The affidavit submitted by the Secretary shows that the final closing could not occur because of the owner's default, and that the practice of increasing the mortgage was not available in the case of such a default (B. 202-05).

Eversley's contention that it was entitled to be paid in *East New York* in February, 1973, after it certified its actual costs, is astonishing in view of the plain terms of the construction contract to the effect that certificates of occupancy and FHA permissions to occupy are also preconditions to payment (A. 91). As we noted in our main brief at 15, the District Court found that no permanent certificate of occupancy had been issued in *East New York* (A. 18; temporary certificates of occupancy expire in 90 days (A. 111)). The permission to occupy form was not even signed on behalf of Eversley until March 7, 1974, more than a year after Eversley claims to have been entitled to payment (A. 221, 237).

---

* Eversley erroneously asserts that the amount of approved change orders in *Brownsville* was $129,409.20 (Brief at 9). Judge Werker found the amount to be $110,297, (A. 8), based upon documentary evidence produced by the Government that Eversley did not rebut. Similarly, as to *East New York* (brief at 6), Eversley ignores the deduction of $12,271.05 that the District Court found because that amount was found by FHA auditors to be improper or unsupported (A. 18).

None of these facts affects the Government's basic contention that, in view of the undisputed fact that the borrowers on the building loans had defaulted, the banks were not obligated to lend and HUD was not obligated to insure any further advances under those agreements. The District Court's contrary holding must be reversed.

ARGUMENT

POINT I

Eversley cannot recover on the theory of an equitable lien.

Eversley's first point on these appeals is that it is entitled to recover on the theory that it had an equitable lien on the retainages. This contention flies in the face of the various documents governing the parties' rights to the funds. The argument is without merit, and it does not even deal with the change orders for which Eversley is seeking to recover.

We have already discussed in our main brief the provisions of the building loan agreements to the effect that no advances need by made by the lender after default by the borrower, and that the lender is not obligated to make any advance unless it will be a first lien against the premises. Likewise, the escrow agreement in *East New York* provides that the amount in escrow may be applied to reduce the borrower's debt in the event of default (Government's main brief at pp. 17-18). The application of Eversley's equitable lien theory would abrogate these plain terms. Eversley had complete knowledge of the terms of these agreements, and was not even a party to them.

Assuming *arguendo* that equitable lien theory applies here at all, it is readily apparent that Eversley, like any

other creditor, must stand in line to collect its due. It is a fundamental principle of lien law that "first in time, first in right" governs the rights of claimants to a fund. *Rankin* v. *Scott*, 25 U.S. 177 (1827); *United States* v. *General Douglas MacArthur Senior Village, Inc.*, 470 F.2d 675, 677 (2d Cir. 1972).

The Government's mortgage liens in the cases at bar became choate when the banks recorded them.* Eversley's lien could not become choate until its claim had met the requirement of "absolute certainty (1) as to the identity of the lienor, (2) as to the property subject to the lien, and (3) as to the amount of the lien." *United States* v. *Sterling National Bank & Trust Co.*, 360 F. Supp. 917, 924 (S.D.N.Y. 1973), *aff'd & rev'd in part on other grounds*, 494 F.2d 919 (2d Cir. 1974), citing *United States* v. *City of New Britain*, 347 U.S. 81, 84 (1954). Under the plain terms of the construction contracts (A. 93; B. 102), the amount actually due Eversley could not become certain. nor could the amount of its lien, until it had certified its actual costs in connection with the construction of the project, which obviously could not and did not occur until construction was complete, years after the mortgages were recorded.

This Court has noted that mortgages held by HUD under the National Housing Act are paramount, *United States* v. *Douglas MacArthur Senior Village, Inc.*, *supra*, 470 F.2d at 680, and that it is not for the courts to alter this priority. *Id.* at 679-81. The application of this principle in the cases at bar requires reversal of the District Court's decision.

Henningsen v. *United States Fidelity & Guaranty Co.*, 208 U.S. 404 (1908); *Prairie State National Bank* v.

---

* Although the record does not reflect the date of recordation of the mortgages, we believe it is undisputed that that occurred shortly after the mortgages were executed in 1970 and 1971.

United States, 164 U.S. 227 (1896); and *East End Bank* v. *Childress*, 322 F.2d 563 (5th Cir. 1963), cited at page 19 of Eversley's brief, are inapposite. They were disputes as to priorities of rights to retainages where the party holding the retainages made no claim to them. Here, of course, to the extent that the Government holds the retainages it claims a superior right to them. None of the cases holds that the holder of the retainages was obligated to disburse them to anyone, and they even imply that the holder's claims, when they exist, are superior.

Prairie State Bank, for example, stated that a surety on a performance bond that had completed a project after the contractor's default was subrogated to the rights of the *Government* (which was the owner of the project) in the retainages, which rights were superior to those of an assignee of the defaulting contractor. 164 U.S. at 232-33, 240. The dispute was between the surety and the contractor as to their priorities. Curiously, Eversley contends that this case stands for the proposition that an equitable lien cannct be defeated by subsequent events. In fact, the case stands for precisely the opposite proposition. The assignee of the contractor was the party claiming the equitable lien, and the assignment occurred *before* the contractor defaulted, and thus before the surety began to complete the contract. Nonetheless, the Court *held* that the assignee's alleged equitable lien was defeated.

In both *Henningsen* and *Prairie State Bank* the holder of the retainages was the federal government as owner of the projects. In *East End Bank* v. *Childress*, the holder was a general contractor, and the dispute was between two parties who claimed to be assignees of a subcontractor's right to the funds in the contractor's possession. The contractor had no claim to the moneys and in fact paid them into court. The court noted in dictum that by virtue of a clause in the subcontract, the retainages were not even due to the subcontractor until all other claims against the contractor were discharged. 322 F.2d at 565.

By implication, had the subcontractor had an equitable lien, it still would not have prevailed over the plain language of a contract setting forth different priorities of claims against a retainage.

In the cases at bar there are express provisions, both of contract and statute, that give the Government or the lender the right to hold the retainages when the borrower on the mortgage has defaulted. The building loan agreements so provide; the escrow agreement in *East New York* so provides; and 12 U.S.C. § 1713(g) provides that in the event of a default, if the mortgagee elects to assign the mortgage, all such sums are to be transferred to the Secretary. See pp. 9, 12-13 of the Government's main brief.

Swinerton & Walberg Co. v. *Union Bank*, 25 Cal. App. 3d 259, 101 Cal. Rptr. 665 (Ct. App. 1972), cited at page 19 of Eversley's brief, most clearly presents the application of the equitable lien theory in a case such as the present. The rule of that case is no longer the law of California, however. Section 3264 of the California Civil Code, adopted in 1967,* provides:

> "The rights of all persons furnishing labor, services, equipment, or materials for any work of improvement, with respect to any fund for payment of construction costs, are governed exclusively by Chapters 3 (commencing with Section 3156) and 4 (commencing with Section 3179) of this title, and *no person may assert any legal or equitable right with respect to such fund, other than a right created by direct written contract between such person and the person holding the fund, except pursuant to the provisions of such chapters.*"

(Emphasis added.)

---

* The *Swinerton* court, though writing in 1972, held this section inapplicable to the project before it, which had been completed in 1965, two years prior to the statute's enactment.

The California Supreme Court has held that this provision "abolished the nonstatutory equitable lien." *Connolly Development, Inc.* v. *Superior Court*, 132 Cal. Rptr. 477, 493 n.25 (Sup. Ct. 1976) (en banc). See also *Boyd & Lovesee Lumber Co.* v. *Modular Marketing Corp.*, 44 Cal. App. 3d 462, 465, 118 Cal. Rptr. 699, 701 (1975). The enactment of this statute suggests the policy considerations that ought to guide this Court in determining whether to adopt Eversley's equitable lien theory in the face of plain contractual and statutory terms that belie Eversley's claim.

Eversley attempts to bolster its equitable lien argument with a reference to regulations recently proposed by HUD (Eversley's brief at 20-21 n.3 and addendum). The proposed rules simply would permit future construction contracts to contain provisions placing 10% of each progress payment in escrow for the benefit of the contractor. *See* 41 Fed. Reg. at 37227, new section 207.26a, in Eversley's addendum. The fact of this proposed amendment makes it clear that unless a contract contains such terms, a party in Eversley's position is not entitled to the retainages after a default by the borrower. *See* 41 Fed. Reg. at 37226, col. 1.

In summary, the authorities cited by Eversley in support of its equitable lien theory do not permit its application in the cases at bar, assuming it to be otherwise sound. We reiterate the language of the District Court for the District of Columbia, in *Trans-Bay Engineers & Builders, Inc.* v. *Lynn*, 396 F. Supp. 265 (D.D.C. 1975), *appeal pending*, No. 75-1976 (D.C. Cir.), quoted in our main brief at page 40:

> "Still, equity will not set aside legal obligations in order to provide relief for parties later disadvantaged, nor will equity rewrite contracts to expand an insurer's liabilities or to restrict a promisee's risks and duties."

396 F. Supp. at 272.

POINT II

The moneys claimed by Eversley are not trust funds under the New York Lien Law; in any event, these claims are barred by the statute of limitations.

Point II of Eversley's brief contends that the undisbursed mortgage proceeds are "trust funds" under Article 3-A of the New York Lien Law. Eversley does not discuss the terms of the statute, which make it clear that these sums are not trust funds. Furthermore, Eversley failed to commence these actions within the statutory limitations period of one year from the completion of construction. N.Y. Lien Law, § 77, subd. 2.

A. Whether The Retainages And Escrow Deposits Are Trust Funds

Article 3-A of the New York Lien Law (§§ 70 to 79-a) provides that certain moneys arising in connection with the improvement of real property are trust funds to be applied to, among other things, the "payment of claims of subcontractors, architects, engineers, surveyors, laborers, and materialmen . . ." N.Y. Lien Law § 71(2)(a). An action to enforce the trust may be brought by either a beneficiary of the trust or by a trustee. N.Y. Lien Law § 77, subd. 1. These trust funds, however, do not include unadvanced loan proceeds or escrow deposits to which the owner of the improvement has no legal right. N.Y. Lien § 70. The owners of the projects in the cases at bar obviously have no right to any moneys in the hands of HUD, since they are in default, and therefore these sums are not trust funds.

Under subdivision 1 of Lien Law § 70, the assets of the trust are limited to

> "funds . . . received by an owner . . . or received by a contractor . . . or received by a subcontractor

> . . . and any right of action for any such funds due or earned or to become due or earned. . . ."

The funds claimed by Eversley have never been received by the owner, by Eversley as contractor, or by any subcontractor, so Eversley must be asserting a "right of action" for the funds. The statute is clear, however, that a right of action is not enlarged merely by being a trust asset; in these cases, even assuming that the unadvanced loan proceeds and escrow deposits Eversley claims are trust funds, the owners' defaults, which would defeat their claims to the funds, likewise defeats Eversley:

> "[A]ny right to receive payment at a future time shall be deemed a right of action therefor and an asset of the trust even though it is contingent upon performance or upon some other event, *but the fact that the right is a trust asset does not enlarge the right or excuse any performance or condition upon which it depends . . . .*"

N.Y. Lien Law § 70(1) (emphasis added).

The cases cited by Eversley do not support its claim on the facts of this case. In the first place, it is obvious that the cases cited merely to show that the purpose of the Lien Law is to protect laborers and materialmen (see pp. 27-29 of Eversley's brief) say nothing about whether a trust arises here, and they do not permit this Court to rewrite the statute.

P. T. McDermott, Inc. v. *Lawyers Mortgage Co.*, 232 N.Y. 336 (1922), cited at page 27 of Eversley's brief, is not a trust fund case at all, but rather a mechanic's lien case. It discusses the purpose of section 22 of the Lien Law, pursuant to which the "lien law affidavits" are annexed to the building loan agreements, but it does not say, contrary to Eversley's brief (p. 27), that one of

the purposes is "to enable those laborers and materialmen to rely on the fact that sufficient monies would be advanced in payment of the services to be rendered by them."

The case says quite to the contrary:

> "The object of section 22 is to acquaint prospective contractors with the fact that *they furnish labor and materials subject to claims prior to theirs* against the property, so far as advances thereunder are prior to their liens when filed (Lien Law, § 13), and also to *inform* such contractors of the amounts to be advanced and the times of such advances."

232 N.Y. at 341-42 (emphasis added). See also *Osinoff* v. *Queens Apartments, Inc.*, 10 Misc. 2d 762, 173 N.Y.S. 2d 225 (Sup. Ct. Queens County 1958).

Thus it is clear that the lien law affidavits are for informational purposes. When the very documents in which the affidavit is contained, namely the building loan agreements on which Eversley relies, also expressly notify all who read them that the lender will cease advancing loan proceeds if the owner defaults, the purpose of the statute has been served, and a contractor cannot fairly claim to rely on those advances in the face of notice that the owner's right to them is not absolute.*

The only cases apparently cited by the plaintiff for the proposition that holdbacks in the hands of a lender are trust funds are *United Lakeland Air Conditioning Co.*

---

* Likewise, the escrow agreement in East New York (A. 101) informs any non-party who may rely on it that upon default, the sums deposited may be applied either by the bank or by the Secretary to sums due under the mortgage. ¶ 3(b), (c) (A. 101). Therefore, the escrow deposits are no more trust funds than are the undisbursed loan proceeds.

v. *Ahneman-Christiansen, Inc.*, 33 Misc. 2d 606, 226 N.Y.S. 2d 532 (Sup. Ct. Nassau County 1962), *aff'd*, 18 App. Div. 2d 1022, 239 N.Y.S. 2d 38 (2d Dep't 1963); *Utica Sheet Metal Corp.* v. *J. E. Schecter Corp.*, 47 Misc. 2d 290, 262 N.Y.S. 2d 583 (Sup. Ct. Albany County 1965), *rev'd in part*, 25 App. Div. 2d 928, 270 N.Y.S. 2d 259 (3d Dep't 1966), *after trial on remand*, 53 Misc. 2d 284, 278 N.Y.S. 2d 345 (Sup. Ct. Schenectady County 1967); and *Pearlman* v. *Reliance Insurance Co.*, 371 U.S. 132 (1962). *See* Eversley's brief at 29-30.

None of these cases supports the proposition. The closest one to the present case is *United Lakeland Air Conditioning Co.* v. *Ahneman-Christiansen, Inc.*, *supra*, in which the court found, under the facts of that case, that certain sums retained by a lender bank were Lien Law trust funds. The circumstances under which the trust was found to arise, however, are so different from the case at bar that the case provides no guidance here.

In *United Lakeland*, as in this case, subcontractors, materialmen, and suppliers sued the bank for what were alleged to be unadvanced loan proceeds under a building loan agreement between the bank and a joint venture of the prime contractor and seven owner corporations. 33 Misc. 2d at 607-08, 226 N.Y.S.2d at 534-35. The funds were specific sums retained and set aside by the bank pursuant to a " 'security deposit agreement', for the completion of a certain items of work . . ." 33 Misc. 2d at 608, 226 N.Y.S. 2d at 535. The "deposit agreement" contained an express acknowledgement by the bank that it had received funds from the building corporations for that purpose. 33 Misc. 2d at 611, 226 N.Y.S. 2d at 537.

The court found that in fact the bank *had* advanced the entire amount of the building loan, including the retained amounts that went into the security deposit, in light of two facts: that the bank had given the receipt for the deposited sums, and that the bank had

closed out the building loan agreements and entered into new contractual arrangements with different borrowers, namely the purchasers of the homes. 33 Misc. 2d at 610-11, 226 N.Y.S. 2d at 537.* Under these circumstances, the court stated that the effect was the same as if the borrowers had deposited their own checks in the bank simultaneously with an advance actually made. *Id.*

The same cannot be said in the cases at bar. There has been no closing out of the building loan agreements, nor has the lender given a receipt for deposits, from which one could infer, as the court did in *United Lakeland*, that the "unadvanced" mortgage proceeds were in effect advanced.

What little relevance remains of *United Lakeland* is further vitiated by the fact that the bank prevailed in that case. It had used the "deposits", except for $4501.23, to improve the real property (after the lawsuit was commenced, at that) and while it argued that the funds were not trust funds, it also argued that it had expended them for the purposes of the trust, if one were found to have arisen. As to the sum of $4501.23, the bank relinquished its claim to it and sought to pay it into court. 33 Misc. 2d at 609, 226 N.Y.S. 2d at 536. The bank thus in effect made a concession that the defendants in the instant cases do not make. The court ruled in the bank's favor in part on the ground that the expenditures were not diverted from the trust's purpose, and the Appellate Division affirmed on precisely and solely that ground. 18 App. Div. 2d at 1022, 239 N.Y.S. 2d at 39. The case thus is not strong precedent as to what would have happened if the bank had applied the deposits to reduce the mortgage

---

* The court stated alternatively that the funds were trust funds under the provision that such funds included the right of action under a building loan contract. 33 Misc. 2d at 611, 226 N.Y.S. 2d at 537-38. That begs the question whether there is such a right of action in this case. Our previous discussion demonstrates that there is not.

principal, as it was entitled to do under some of the deposit agrements. 33 Misc. 2d at 611, 226 N.Y.S. 2d at 537.

The next case cited by Eversley apparently for the proposition that the holdbacks are trust funds is *Utica Sheet Metal Corp.* v. *J. E. Schecter Corp., supra.* The case has no relevance here, for the funds involved were concededly, and obviously, trust funds—they were payments by the owner to the contractor, deposited by the contractor in the defendant bank. As to the bank they were merely deposits, not unadvanced loan proceeds.

Pearlman v. *Reliance Insurance Co.*, 371 U.S. 132 (1962), also cited by Eversley, is equally irrelevant. The government in that case was the "owner" of the project involved, not merely a guarantor of a loan between two other parties as it is here, and it *conceded* that it had no interest in certain sums retained under the construction contract. 371 U.S. at 134. Indeed, the government was not a defendant. The dispute was as to priority in the retainages as between the general contractor's trustee in bankruptcy and the surety that had paid laborers and materialmen, pursuant to its payment bond, after the contractor's failure to do so. *Id.* at 133. The Court held for the surety under the simple theory of subrogation in the fund.

The *Pearlman* case does not have anything to do with rights of an alleged trust fund beneficiary in retainages when the United States also claims a right to them. A case that does, and which holds for the United States, is *United States* v. *Munsey Trust Co.*, 332 U.S. 234 (1947), which held that the United States could set off against retainages claims it had against a construction contractor arising out of a project that did not even generate the retainages, as against the claim of the surety that had paid subcontractors and materialmen. This holding was reaffirmed in *Pearlman*, 371 U.S. at 14.. *A fortiori*, in

the cases at bar the United States can set off against the retainages, the claims it has against the borrowers that have defaulted on the building loan agreements.

The Court in *Munsey Trust Co.* noted that it had been well-established that, even in a construction contract directly with the United States, laborers and materialmen were not entitled to be paid by the United States if the contractor failed to pay them. 332 U.S. at 241. Their protection is in statutes requiring a payment bond on public contracts. Similar protection is available in the instant case (A. 203-07; B. 184-88). A *fortiori*, where the construction contract is between Eversley and a private owner, and the retainages are withheld, not pursuant to that contract but pursuant to a loan agreement between a lender and the owner, there is no basis for finding that the contractor has a right to such retainages.

Needless to say, *Pearlman* and *Munsey Trust Co.* have little to do with trust funds under the New York Lien Law. It is worth noting in passing, however, that the *Munsey Trust Co.* result in favor of the United States would obtain under New York law as well, under the facts of these cases. In *Peoples National Bank & Trust Co.* v. *Harkay Realty Co.*, 258 App. Div. 964, 16 N.Y.S. 2d 779 (2d Dep't 1940), persons holding mechanic's liens (which Eversley does not) sought to compel a bank to make advances under a building loan agreement after the owner had defaulted. The agreement and mortgage expressly "relieved the lender from making advances after default," as does the agreement in the Eversley cases, and the court held, just as one might expect, that it had no obligation to do so in favor of mechanics' lienors. The court distinguished an earlier case, *Cerasole* v. *Egenberger*, 273 N.Y. 351, 7 N.E. 2d 259 (1937), as involving "a separate agreement with lienors, for a good consideration, to advance the full amount of the loan without regard to default." 258 App. Div. at 964, 16 N.Y.S. 2d at 780. There is no such agreement in the cases at bar, and the

lenders are therefore entitled to rely on their agreements relieving them from making advances after the owner's default.

B. The Statute of Limitations

The foregoing discussion makes it evident that the funds sought by Eversley in its "class action" under Article 3-A of the New York Lien Law are not in fact trust funds under that article. Eversley is also barred by the applicable statute of limitations. Section 77, subd. 2 of the Lien Law provides:

> "No such action [to enforce a trust] shall be maintainable if commenced more than one year after the completion of such improvement . . . ."

While the complaints in these actions, which were commenced in December 1974, allege that this one-year period had not then elapsed (A. 34; B. 14), Eversley's own papers on the motions for summary judgment in the District Court are clear that that is not the case. Thomas Eversley's *Brownsville* affidavit (B. 41-42) notes that temporary certificates of occupancy were obtained for the two buildings in the project on August 24, 1972 and January 18, 1973. The latest completion could have occurred was the date of Eversley's cost certification on February 12, 1973 (B. 42). On those pages of his affidavit, Mr. Eversley reiterates several times that the project was then fully completed. The latest of these dates is close to two years before these actions were commenced.

The same result obtains in the *East New York* case. On page 8 of his affidavit in that case (A. 64), Mr. Eversley states, "The buildings of the project were completed in October, 1972". Temporary certificates of occupancy were obtained in November, 1972.

Thus Eversley's claims for relief under the New York Lien Law are barred by the statute of limitations.

In its reply brief in the District Court (pp. 7-9), Eversley attempted to rebut this defense by contending that the limitations period under section 77(2) began to run only after the date of formal completion.

The principal case Eversley cited was *Biondo* v. *City of Rochester*, 18 App. Div. 2d 78, 238 N.Y.S. 2d 7 (4th Dep't 1963). Eversley neglected to note that that case was not construing section 77(2) of the Lien Law, which provides that the period begins to run from "the completion of such improvement," but rather another section of the Lien Law, governing the time within which mechanics' lienors must file liens. That time began to run from "completion *and acceptance*" of the project under the plain terms of the statute. The Court defined "completion" as referring solely to "the termination of the physical work . . ." The formalities were governed by the term "acceptance," which does not appear in the statute of limitations that governs the cases at bar. 238 N.Y.S. 2d at 14.

Wynkoop v. *Mintz*, 17 Misc. 2d 1093, 192 N.Y.S. 2d 428 (Sup. Ct. Kings County 1958), and *Forest Electric Corp.* v. *Century National Bank & Trust Co.*, 70 Misc. 2d 190, 333 N.Y.S. 2d 644 (Sup. Ct. N.Y. County 1970), which Eversley also cited, stand for the same proposition, that the time within which to enforce a Lien Law trust commences from the date the project is completed. *See also Ingalls Iron Works Co.* v. *Fehlhaber Corp.*, 327 F. Supp. 272, 281-82 (S.D.N.Y. 1971) (Pollack, J.). Eversley should be bound by its own sworn insistence that the projects were completed substantially more than one year before these actions were commenced, and its Lien Law claim should be held to be barred.

POINT III

Eversley is not a third-party beneficiary of the building loan agreements.

In our main brief at pages 19-29, we discuss at length the traditional criteria that a party claiming to be a third-party beneficiary must meet, and we demonstrate that Eversley does not meet them. No contract upon which Eversley relies (namely the building loan agreements) calls for any performance directly to Eversley, and a party who only incidentally benefits from another party's performance of contractual obligations cannot recover as a third-party beneficiary. See Government's main brief at 20.

The contrary holding of *Travelers Indemnity Co.* v. *First National State Bank*, 328 F. Supp. 208 (D.N.J. 1971), is erroneous, since the contractor in that case could only be an incidental beneficiary, and of course that decision is not binding on this Court. The similar contrary holding in *Trans-Bay Engineers & Builders, Inc.* v. *Lynn*, 396 F. Supp. 265, 270 (D.D.C. 1975), *appeal pending*, No. 75-1976 (D.C. Cir.), is vitiated by the fact that the Government nevertheless prevailed on the theory that the contractor was in no better position than the borrower, who of course could not recover further sums after its default. Eversley's response to this logical result is to ask this Court to ignore it. (Eversley's brief at 41).

Since neither the Government nor the lenders have any further obligations to the borrowers under the building loan agreements, they can have no obligations to Eversley, even assuming that Eversley is a third-party beneficiary of those agreements.

POINT IV

These actions are barred by sovereign immunity.

Eversley advances several bases of jurisdiction which it alleges would defeat the Government's claim that sovereign immunity bars recovery on the theories found by the District Court. None of Eversley's contentions has merit.

28 U.S.C. §2410

Eversley asserts that the District Court had jurisdiction under 28 U.S.C. § 2410. This section is not an independent basis of district court jurisdiction. *Remis* v. *United States*, 172 F. Supp. 732, 733 (D. Mass. 1959), *aff'd*, 273 F.2d 293 (1st Cir. 1960); *Schmitz* v. *Societe Internationale*, 249 F. Supp. 757, 762 (D.D.C. 1966), *apparently aff'd mem.*, (D.C. Cir.), (unreported), *cert. denied*, 387 U.S. 908 (1967). In *Remis*, Judge Aldrich examined the legislative history of the statute and found

> "it reasonably apparent that what concerned Congress was admitting the government into actions as an additional party when necessary for complete relief, and not the creation of new jurisdiction in the federal courts for the special purpose of suing the government."

172 F. Supp. at 733. Thus Eversley must turn to some other statute to find jurisdiction of this action.

Secondly, Eversley's brief (at p. 44) is clear that it seeks to invoke this statute to enforce an equitable lien. Indeed, that is the only kind of lien Eversley claims to have. Unfortunately, Eversley cannot meet requirements that have been established by cases before an equitable lien can be impressed upon Government funds:

> "[T]he Treasury officials must be charged with the performance of no duty other than the ministerial

> duty of making disbursement of the fund. It must be such a duty as could be compelled by mandamus, or a receivership. The United States must not be in the position of a debtor or creditor, but the fund must be an especially earmarked account to which the Treasury officials are under no other responsibility than that of the ordinary stakeholder, and the United States must have no claim or interest in the fund."

Schmitz v. *Societe Internationale*, *supra*, 249 F. Supp. at 762. Here, of course, the United States is a creditor of the borrower under the building loan agreement, and claims an interest in the funds Eversley claims. Thus, even if Eversley would otherwise have an equitable lien, which we do not concede, it cannot be enforced in these cases.

28 U.S.C. § 1346(a)(2)

Eversley next asserts (brief p. 45) that the District Court had jurisdiction under the Tucker Act, in that this is a suit on an express contract, namely the building loan agreements. It is plain that no express provision of the building loan agreements entitles Eversley to recover, and the argument does not even address the escrow agreement and the change orders upon which Eversley also sued and prevailed. More importantly, if Eversley now, for the first time, asserts jurisdiction under the Tucker Act, it could not recover more than $10,000 in the District Court. 28 U.S.C. § 1346(a)(2). A suit for a greater amount can only be brought in the Court of Claims. 28 U.S.C. § 1491; *Putnam Mills Corp.* v. *United States*, 432 F.2d 553 (2d Cir. 1970).

12 U.S.C. § 1702

This is the "sue and be sued" clause which allows the Secretary to sue and be sued in her own name in her official capacity, which would not be allowable otherwise.

Blackmar v. *Guerre*, 342 U.S. 512, 515 (1952); *Economou* v. *United States Department of Agriculture*, 535 F.2d 688, 691 (2d Cir. 1976). We have already discussed the inapplicability of this section in our main brief at 36 n.**. To the extent that it is a waiver of sovereign immunity, it is extremely limited:

> "The FHA is an administrative unit of the government and the authorization of suits against it was simply a waiver of sovereign immunity to make it amenable to process to the same extent that a private corporation would be under like circumstances, but it did not create a cause of action against the government where none existed previously."

Choy v. *Farragut Gardens*, 131 F. Supp. 609, 613 (S.D. N.Y. 1955) (Weinfeld, *J.*).

Contrary to Eversley's assertions, waivers of sovereign immunity must be strictly construed. *Brown* v. *General Services Administration*, 507 F.2d 1300, 1306-07 (2d Cir. 1974), *aff'd*, 44 U.S.L.W. 4704 (U.S. June 1, 1976). The frequently cited case of *Federal Housing Administration* v. *Burr*, 309 U.S. 242 (1940), merely held that limitations on *procedural* remedies, in that case garnishment, were not to be implied, where the subject matter of the suit was otherwise properly before the Court.

None of the foregoing authorities sustains the position that Eversley must maintain to prevail on this appeal. As we have shown in our main brief, the basis of the recovery imposed by the District Court was unjust enrichment, which is a theory of contract implied in law, for which Congress has not waived the Government's sovereign immunity. Government's main brief at 37-38.

POINT V

Eversley is not entitled to recover either pre- or post-judgment interest.

The authorities Eversley cites in support of its contention that it is entitled to interest in these cases (not distinguishing between pre- and post-judgment interest) do not justify that conclusion. *Travelers Indemnity Co.* v. *First National State Bank*, 328 F. Supp. 208, 217 (D.N.J. 1971), simply states that the plaintiff was to recover judgment "plus lawful interest." It does not state whether that interest was pre- or post-judgment. While *United States* v. *Lincoln Neighborhood Community Ass'n*, No. 73-30 (N.D. Fla. October 16, 1975), *appeal pending*, No. 75-4069 (5th Cir.), appears to have awarded pre-judgment interest against the United States (Government's addendum at 9), it is apparent that the argument we make here was not brought to the Court's attention (this appears to be the case in *Travelers Indemnity Co.* as well). The pending appeal in *Lincoln Neighborhood* includes the Government's cross-appeal from that portion of the decision that was adverse to it.

It is surprising that Eversley cites (at page 48 of its brief) *Royal Indemnity Co.* v. *United States*, 313 U.S. 289 (1941), since the case did not concern the recovery of interest against the United States. The United States was the plaintiff in that case and recovered interest against the defendant.

The cases cited by the Government at page 43 of its main brief expressly considered the question of the recovery of interest against the United States, and they require that the Government's position on this point be sustained.

Eversley appears to cite 28 U.S.C. § 2410(d) as a waiver of sovereign immunity on the question of interest. That subsection only concerns the amount to be paid by

the United States in certain circumstances when it redeems *real* property that has been sold at a foreclosure sale. The provision has no applicability to the cases at bar.

Eversley next cites the introductory comments to HUD's proposed rules concerning holdbacks, 41 Fed. Reg. at 37226, col. 2, a copy of which is annexed to Eversley's brief. The passage cited merely says that under the proposed regulations the holdbacks *may* be placed in an interest-bearing escrow account *if* the mortgagor and the contractor so agree, and that the interest earned shall be paid to the contractor. No such events have occurred in the cases at bar, and even under the proposed regulations that interest would not be paid by the United States, but only from the bank account in which the escrow funds were deposited.

In summary, Eversley was not entitled to recover any interest, either pre- or post-judgment, in these cases.

CONCLUSION

For the reasons stated in this reply brief and in the Government's main brief, the judgments of the District Court should be reversed and the complaints should be dismissed.

New York, New York
October 26, 1976

Respectfully submitted,

ROBERT B. FISKE, JR.,
United States Attorney for the
Southern District of New York,
Attorney for Defendant-Appellant Hills.

PETER C. SALERNO,
PATRICK H. BARTH,
Assistant United States Attorneys,
Of Counsel.

Form 280 A-Affidavit of Service by Mail
Rev. 12/75

AFFIDAVIT OF MAILING

CA 76-6097
76-6098
76-6099

State of New York)
County of New York) ss

Marian J. Bryant being duly sworn, deposes and says that she is employed in the Office of the United States Attorney for the Southern District of New York.

That on the 28th day of October, 1976 she served two copies of the within Reply Brief for Defendant-Appellant Hills

by placing the same in a properly postpaid franked envelope addressed:

Eugene J. Morris, Esquire
Demov, Morris, Levin & Shein
40 West 57th Street
New York, New York 10019

Samuel D. Rudey, Esquire
Weisman, Celler, Spett, Modlin,
Wertheimer & Schlesinger
425 Park Avenue
New York, New York 10022

Kaufman, Taylor, Kimmel & Miller
41 East 42nd Street
New York, New York 10017

And deponent further says she sealed the said envelopes and placed the same in the mail chute drop for mailing in the United States Courthouse Annex, One St. Andrews Plaza, Borough of Manhattan, City of New York.

Marian J. Bryant

Sworn to before me this
28th day of October, 1976

Ralph I. Lee

RALPH I. LEE
Notary Public, State of New York
No. 41-2292838 Queens County
Term Expires March 30, 1977